# COMMENTS BY ONTARIO HYDRO

# ON

# PROFESSOR CURRIE'S REPORT

# TO THE

# ONTARIO ECONOMIC COUNCIL

# ON THE BRIEF OF THE

# NIAGARA BASIC POWER USERS' COMMITTEE

# TO THE

# GOVERNMENT OF ONTARIO

October 1, 1962

COMMENTS BY ONTARIO HYDRO ON PROFESSOR A.W. CURRIE'S REPORT TO THE ONTARIO ECONOMIC COUNCIL CONCERNING THE BRIEF BY THE NIAGARA BASIC POWER USERS' COMMITTEE TO THE GOVERNMENT OF ONTARIO

We are pleased to have the opportunity of commenting on the Report by Professor A.W. Currie to the Ontario Economic Council with respect to the Brief by the Niagara Basic Power Users' Committee to the Government of Ontario.

Professor Currie summarizes his conclusions and recommendations on pages 27 and 28 of his Report and we will restrict our comments to these main points.

(a) "To lengthen the term of contracts for power from 5 to 10 years or more seems to be impractical from Hydro's standpoint."

While Professor Currie acknowledges the Committee's demands for long term contracts at a firm rate, he nevertheless realizes that Ontario Hydro's costs are subject to upward pressures as in the case of all other industries in Canada and he concludes that it is unrealistic to suggest that a power rate could be equitably maintained over a long period. In other words, he appears to conclude that any long term rate would have to be designed to meet average cost conditions over the period in question and would have to be higher

than estimated costs in earlier years to offset anticipated deficits in later years.

Since Ontario Hydro supplies power at cost, it has contended that it is in the best interest of both the Industrial customers and the Commission to have annual rate review provisions in power contracts so that rates can be closely tailored to the estimated cost of supply; however, the Niagara Basic Power Users have placed great emphasis on the need for fixed rates for a longer term than one year, and the Commission has agreed to a term of five years for these particular contracts.

One might question if any member company of the Niagara Basic Power Users' Committee would undertake a similar guarantee in the form of a fixed price for its products to its customers over a long term period, or even for five years.

(b) "The problem of an equitable rate structure is enormously complex, but I feel that these Users are entitled to some sort of reduction in their existing rates because they are all within twelve miles of the source of their power. This is not a subsidy, but a recognition of cost."

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Professor Currie dwells in some detail on the matter of possible cross-subsidization resulting from our costing procedures and rate policies. He suggests that

new and higher cost generation must be added to supply new customers and because of the Commission's policy of pooling the costs of all generation, the old customers may be subsidizing the cost of power to the new customers; however, he concludes that all customers, not only the newly added ones, are using more power year after year and, therefore, all customers are responsible for the need to develop new sources of generation.

This fact was substantiated in previous briefs from Ontario Hydro to the Niagara Basic Power Users' Committee in reply to the statements that the member companies, being large and long established users of electric power in Ontario, were entitled to the sole right of the benefits of low cost generation from the original plants in the Niagara area at the expense of the municipal utilities and other customers in the Province. By 1917, when the Commission commenced supplying this group of industries, 95 municipalities, with loads totalling approximately 90,000 kilowatts, were served from Niagara generation as compared to 45,000 kilowatts used by these industrial customers in the Niagara area. On completion of the Sir Adam Beck Generating Station No. 1 in 1924, the load of these industrial customers totalled 80,000 kilowatts or 17 per cent of the total Niagara System load of

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463,000 kilowatts. The remaining 83 per cent consisted chiefly of loads taken by the municipal utilities, including the 14 original municipalities responsible for the formation of the Provincial Commission, namely London, Toronto, Guelph, Stratford, St. Thomas, Woodstock, Galt, Kitchener, Hespeler, St. Marys, Preston, Waterloo, New Hamburg and Ingersoll; municipalities which have taken power since 1911. Since 1924, Ontario Hydro has provided system capacity at varying costs to meet the power requirements of all customers and the fact that the demands of the Niagara Basic Power Users have increased from 80,000 kilowatts in 1924 to over 300,000 kilowatts in 1961, should be a clear indication that this particular group should share the increasing cost of the system facilities over the years.

While Professor Currie concurs with the necessity of pooling generation costs, he contends that the distance of transmission should be taken into account, stating that the industries should not be denied the advantages of their location nor should the disadvantages of unfavourable locations be neutralized by a policy of uniform rates.

Having agreed that the cost of generation should be pooled, one might have expected that Professor Currie would also agree with the pooling of 230 kv and 115 kv line costs, since these lines are an integral part of

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the generating sources of this Province. A glance at a map of the power system in Ontario focuses one's attention to the widespread distribution of Ontario Hydro's hydraulic generating plants. These plants could not have been constructed economically if the Commission had been forced to rely on local loads to justify the large capital expenditures involved. It was the development of a massive transmission grid which enabled Ontario Hydro to utilize almost immediately all the power from these large hydraulic sites and to deliver the total output of these plants to industries and homes alike across the Province at most favourable costs.

For example, construction of the Robert H. Saunders - St. Lawrence Generating Station was feasible only because the Commission had a large and wide ranging market for the power. There was no power load in eastern Ontario which would have justified the construction of such a large and economical plant. Similarly at Niagara, the loads of the Niagara Basic Power Users were not large enough to justify the construction of either the Sir Adam Beck-Niagara Generating Station No. 1 or No. 2. Economies of construction were only realized by supplying power to more distant centres.

This is also true of the sites in northern Ontario and the present construction of hydraulic generating stations in the more remote areas on the Abitibi and Mattagami Rivers

is a case in point where, despite the necessity for extensive and costly transmission facilities, these plants will deliver power to major load centres in the south at rates equal to or less than thermal plants in the Metro Toronto area. The construction of such plants is only warranted by the development of the southern Ontario load.

Faced by continuing demands from its customers the Commission has had to proceed with new sources of generation in the form of coal-burning thermal plants. These thermal plants are usually located in major load centres and therefore can be incorporated into the system with a minimum expenditure for 230 kv or 115 kv transmission.

Moreover, the high-voltage transmission grid enables Ontario Hydro to interconnect its system with major utilities thus providing stability as well as markets for surplus energy which is available from time to time. Thus electric power is supplied to its customers from diverse sources through a comprehensive network in which the 115 kv - 230 kv grid is an integral part of the whole generation and main transmission system. The high-voltage grid ensures that the maximum advantage can be taken of diversity of sources and loads and the Commission can thereby effect major economies in capital and operating costs and transmission losses.

Since these advantages and benefits are enjoyed by all customers, the cost of creating and extending them should be shared by all customers. In view of the complex and

interdependent nature of the major power grid this can only be equitably accomplished by pooling the cost of a 115 kv and 230 kv transmission lines.

The Niagara Basic Power Users are the beneficaries of the economies which arise from these interconnections and of the ability of Ontario Hydro to construct optimum sized plants; accordingly they should bear part of these pooled transmission costs. Furthermore, it is well to keep in mind that any departure from this system would result in higher costs for many areas such as Windsor, London, Chatham, St. Thomas and so on.

A comment is made in the Report that recognition is given to the distance of transmission in the costing of power to municipalities and, therefore industry should be given the same consideration. In costing both direct industrial loads and the municipal utilities, high voltage transmission costs are pooled; on the other hand, the costs of low voltage lines (44 kv, 27.6 kv, 13.8 kv) are assessed on kilowatt-miles, the mileage being the distance of the load from the nearest terminal station. Here again, in the costing of this function (low voltage lines), all wholesale loads, direct industrial customers and municipal utilities alike are treated in the same manner.

(c) "Hydro's intensive campaign to increase the domestic consumption of electricity should be carefully examined in the light of the rapid growth of demand from present

customers and for present requirements, and the need to find and develop more expensive sources from electric power sites in Northern Ontario, coal, and atomic power. A proper balance should be struck between providing the amenities of life and providing jobs insofar as low hydro-electric rates contribute to an increase in the volume of manufacturing."

To adequately deal with this question, one must consider the two separate phases of the Hydro enterprise in Ontario, viz: The retail operation and the wholesale operation.

In the retail field, 355 municipal utilities and Ontario Hydro, through its rural system, supply electric service to approximately 2,000,000 customers, of which 1,500,000 are classified as Residential. These customers, supplied under the concept of "Power at cost", have associated hydro supply with abundant, low cost electricity. Until the mid-fifties, electricity was the only convenient source of energy readily available to the majority of household uses and not until then did natural gas become available in most areas of the Province.

With the relatively high standard of living in Ontario and this lack of competition in the energy market, the municipal utilities and the rural system acquired new load with little or no promotional effort. Thus, the kilowatt-hour consumption for residential customers in Ontario

reached a high level compared to other utilities in Canada, in the United States and, in fact, in the world due to the high saturation of high kilowatt-hour use appliances such as ranges and water heaters and a wide range of lower use appliances. With increased kilowatt-hour consumption, the cost per kilowatt-hour for customers served by the municipal utilities dropped from 2-1/2 cents in 1920 to 1.13 cents today.

To meet this rapidly expanding retail market for electric energy, the municipal utilities and Ontario Hydro by the mid-fifties had invested approximately 470 Millions of dollars in the distribution system. Capacity was provided to meet the requirements of full electrical living.

With the advent of natural gas in 1954, Ontario Hydro and the municipal utilities foresaw the possible loss in revenue if the gas companies were successful in acquiring the major appliance loads. It was early recognized that gas would make inroads in the home heating field to the detriment of oil, and having established "the foot in the door", the gas companies would strive to attract high energy use appliances, such as ranges and water heaters, from the electric utilities.

Thus, the electric utilities were forced to take steps to protect their substantial investment in retail distribution plant by actively promoting the use of electric

energy and its advantages. Recent records of kilowatt-hour consumption in subdivisions with a predominance of gas appliances compared to subdivisions with all electric appliances have shown that the concern about the loss of vital electric loads to competitive fuels was well founded.

An electric utility requires approximately the same expenditure for distribution facilities to supply a subdivision whether the major appliances are gas or electric. From a revenue standpoint the customers in a normal electric home of today, even without any electric space heating, use about 750 kilowatt-hours per month as compared to 200 or 250 kilowatt-hours in homes equipped with a gas range, gas water heater, and gas clothes dryer. This reduction in kilowatt-hour use results in a reduction of utility revenues per customer of approximately 50%. For every 10,000 homes fully equipped with gas appliances instead of electric, the municipal utilities and Ontario Hydro will lose some $600,000.00 per year in revenue and if 10,000 homes per year were lost in this way to the gas companies for a period of ten years, the electric utilities would lose a revenue of some $33,000,000.00. Such loss of revenue can only result in higher distribution system costs per kilowatt-hour and higher customer rates.

To illustrate that the municipal utilities in Ontario, whose residential customers have the highest

kilowatt-hour use, are able to supply power to these customers at the lowest rates, the following tabulation has been prepared. In this tabulation, the utilities are grouped according to residential customer kilowatt-hour use and the average charge to each group determined:

| No. of Municipal Utilities | Monthly Kwh Consumption for Residential Customers | Average Monthly Kwh per Customer | Average Charge per Kwh to Residential Customers |
|---|---|---|---|
| 10 | 90 - 199 | 149 | 2.97¢ |
| 62 | 200 - 299 | 250 | 1.60¢ |
| 94 | 300 - 399 | 338 | 1.30¢ |
| 135 | 400 - 499 | 441 | 1.18¢ |
| 69 | 500 - 599 | 541 | 1.11¢ |
| 12 | 600 - over | 636 | 0.87¢ |

This phenomenon is evident in the operations of all electric utilities and the promotion of increased kilowatt-hour use is not unique in Ontario. Our neighbouring utilities, investor-owned and publicly-owned alike, have long recognized the need to promote energy sales in the face of aggressive competition from companies distributing gas and other forms of energy. These American Electrical Utilities have been encountering this kind of competition for many years. In the face of aggressive promotional campaigns by the Gas Utilities, they have found that they had no alternative but to undertake vigorous promotional efforts if they were to remain competitive and ensure an optimum utilization of resources in the public interest.

Professor Currie refers to the investigations of Ontario Hydro into the heating field and expresses apprehension about the effect of this very special load on our costs.

Very thorough studies have been undertaken by Ontario Hydro on the feasibility of electric space heating and considerable data have been accumulated, all supporting the conclusion that the promotion of this very special load will be to the financial advantage of the retail operation of the municipal utilities and the rural system. These studies have proven that the diversity on electric heating is much greater than previously contemplated and that it can be supplied at cost quite comparable with other forms of heating.

Furthermore, people today recognize the advantages of electric heating -- clean, quiet, efficient, controllable. Just as our customers in this century have moved in the use of heating fuels from wood and coal to oil and gas, they are now looking to the total electric living concept. There are over one million homes electrically heated in the United States and the experience of one public utility is that 90% of all new homes are electrically heated. In Ontario, we estimate that there will be 64,000 homes electrically heated by 1970, and 250,000 homes by 1980. Also, the electric utilities now recognize that electric heating itself is a beneficial retail load and the fact that in an electrically heated home, all major appliances, such as the water heater, the range, the clothes dryer, etc., will be electric. Again,

such increased use of electric energy lowers distributing and operating costs per kilowatt-hour sold, and most favourably protects retail rate levels.

Having dealt with the retail phases of the increased sale of electric energy to residential customers, it is pertinent to review the effect on the wholesale cost.

To those who have made a careful study of the economics of electric power supply, the cost factors associated with the present and future stages of development of the Ontario Hydro power system are favourable to the promotion of load growth. Ontario Hydro has developed the major economic hydraulic resources in the Province and has interconnected these resources with a large high voltage transmission grid. Major technological advances and economies are being made in thermal generation as the size of the units increase. Ontario Hydro is now installing 300,000 kilowatt units and is considering adopting 500,000 kilowatt units. As the system expands, 1,000,000 kilowatt units which are now being installed in the larger systems in the United States will also be practical in Ontario, resulting in even lower production costs per kilowatt-hour. Furthermore, thermal plants can be advantageously added to a power system with a large base of low cost hydraulic power, despite the relatively

higher fuel costs of thermal generation, for following reasons:

(1) Since large thermal plants can be constructed in Ontario today at a proportionately lower capital cost per kilowatt of new hydraulic plants, the cost of using thermal to provide peak power and for stand-by generation for use in emergency situations is very favourable;

(2) Thermal plants provide an economic means of supplementing hydraulic resources in periods of low river flows and water storage, and also permits the fuller use of these water storages under normal conditions.

(3) Since thermal plants are normally constructed in areas of high load density, their power output can be delivered to the system with relatively lower expenditures for transmission facilities than would be required for widely scattered hydraulic plants.

These factors, plus the fact that operating costs of the wholesale system are not directly proportional to load growth, indicate that, based on constant dollars, the incremental cost of serving new load including estimated electric heating load during the next 20 years will actually be lower than the average cost per kilowatt-hour today.

Therefore, we do not share Professor Currie's concern over the effect of our promotional efforts on the cost of power in future, and it is somewhat incongruous that criticism of Ontario Hydro's promotion programs should come from the Niagara Basic Power Users, who stress their own critical competitive situation in all their discussions with us. Many industries spend money on advertising and other promotional activities for one reason only -- to keep their volume up and thus keep unit costs down. This is precisely what Ontario Hydro and the municipal utilities are doing in an attempt to protect their customers' interests.

Furthermore, the costs associated with these promotional activities are largely recovered in a limited period of time by increased revenues. Also, let us not lose sight of the fact that the major portion of the Canadian Electrical Manufacturing industry is located in Ontario, and that this Ontario industry receives much needed stimulation from our sales activities in a wide range of electrical products, ranging from generation and transmission equipment to transformers, and last but not least, the many types of utilization equipment and electrical appliances. To this must be added the additional business accruing to the electrical contractor and the retail electrical trade, all stimulating the ecomomy of the Province. Furthermore, an increased Ontario market

for electrical appliances and equipment will lower unit production costs and thereby improve the competitive position of the electrical industry in the export market.

(d) "The need of establishing an Appeal Board to review Ontario Hydro's decision re rates to industrial customers."

Professor Currie concludes that some machinery is necessary to deal with complaints such as received from the Niagara Basic Power Users. The Power Commission Act provides that Ontario Hydro is the Rate Regulatory Board for the Province of Ontario and the suggestion that a Board should be established to supervise an existing Regulatory body seems unnecessary.

Normally, the function of a Rate Regulatory Board is to limit the profits of an industry supplying an essential public service to a reasonable return on its investment, and to approve such rates as will produce this return; however, in the case of a public power authority such as Ontario Hydro operating on a cost basis, there are no profits to limit, and therefore no need for such action by another Regulatory body. Those items which can be included in our cost are outlined in general terms in Legislation, which of course is oriented to the costing of power for the co-operating municipalities. This is to be expected, since they have the major equity share in the power system, paid for in their cost of power. But at the same time, power supplied to direct industrial customers

is costed in the same manner as that supplied to utilities, and rates established on such cost. Thus, any decision by another Regulatory Body in the interests of any small group of industrial customers such as The Niagara Basic Power Users must be reflected in the costs to other direct industrial customers, the co-operating municipalities and the rural system, the latter two entities serving over two million customers throughout the Province. Any new Regulatory authority must therefore, of necessity, become involved in the intricate details of our power costing system, an activity which must involve substantial numbers of staff and associated cost. This would be not only a duplication of the Commission's work, but to a large measure, that of the Auditors appointed by the Province to keep the Commission's accounts continuously under surveillance.

The Commission is ever-mindful of its responsibilities with respect to the industrial development of the Province of Ontario and any rate adjustments to industrial groups such as the Niagara Basic Power Users, or the mines and paper companies, are carefully weighed. Meetings have been held with the Niagara Basic Power Users' Committee over a period of two years and the response by the Commission to this group's representations surely indicate its interest and desire to solve mutual problems with its customers. It is doubtful if an outside Regulatory Board would be in a position to do as much.

It is appropriate to ask whether there is any service or safeguard that could be provided by an Appeal Board that is not being supplied by the Commission itself. If an Appeal Board were established in Ontario its raison d'etre would be the determination of the rates to apply to group or individual customers, presumably under the concept and principle of power at cost. Any reduction in the rates to one group of customers must be compensated by an increase in rates to others. Any appeal from the Appeal Board Review would presumably be to the Ontario Executive Council. The situation would, therefore, not be any different than it is at the present time; an appeal from the Commission's rate making decision to the Cabinet.

An Appeal Board, before passing judgment on rates set by Ontario Hydro under its power at cost principles, would find it necessary to examine all the procedures used to equitably assess the costs of supply to each of the hundreds of wholesale customers. It is reasonable to assume that the Board would only meet infrequently to hear appeals, and since it could not accept the Commission's figures on cost and still satisfy the complainant, it would require a competent staff to supply and assess a wide range of information, resulting in considerable expense.

The Commission must therefore conclude that an Appeal Board is neither necessary nor practical because

it cannot conceive of such an Appeal Board Review serving any function or purpose that is not already being discharged by Ontario Hydro, whose continuing growth depends upon the prosperity and industrial development of the whole Province. The Commission takes second place to none in seeking this objective.

Ontario Hydro brings these points to the attention of the Ontario Economic Council in order that a fair assessment of this proposal should be made.

(e) "In sum, the requests of the N.B.P.U.C. are part of a much wider problem. My assignment was given to me verbally, not in writing. Hence, I cannot be certain that I have stuck within my terms of reference. I have the feeling that I have gone beyond them. Anyway, the gist of my report is that Hydro's policies need to be critically examined to make sure that the people of the Province, as consumers, are not placed too far above their interests as producers. Hydro-electric power is becoming a scarce resource. The pricing mechanism is one means of rationing this resource among numerous uses. Care should be taken to set prices (i.e. rates) so that, besides covering the operating and other costs of Hydro, they will contribute to the long-run development of Ontario. Finally, since water is but one of several sources of light, heat, and power available to the people of Ontario, rates for hydro-electricity must take into consideration the use of coal, atomic energy, petroleum, and natural gas for the same purposes."

Professor Currie has underlined the "gist" of his Report for emphasis. He raises a question which is very complex and social in nature in suggesting that Ontario Hydro, in its pricing policies, should consider, and differentiate between, the role of the people of Ontario as consumers and their role as producers. He implies by his statement that the interest of consumers should not be "placed too far above their interest as producers", that residential users occupy a preferential position vis-a-vis producers, and that since hydraulic power sites are becoming scarce resources, this preference should not be too wide. As will be shown later, there is no grounds for this belief that the residential consumer has held a comparative advantage over the producer.

There is also a suggestion in Professor Currie's report that the Commission should restrict its expansion and reserve any low cost power for industrial purposes. The Commission believes that such a change in policy is neither necessary nor desirable.

The low cost hydraulic resources of this Province have, in fact, been already developed; new sources of power, irrespective of any acceleration of load growth due to promotion, will, for the most part, be thermal, with fossil or nuclear fuel.

The Commission has faith in the major benefits that

electric energy can bring to our Province and our society. Those parts of the world with the most abundant supplies of low cost electricity have the highest standards of living. The Commission's policies are aimed at not only providing adequate supplies of electric energy, but to make the most efficient use of its power system to ensure lowest possible costs, and in turn, low rates for both domestic and industrial use.

In supplying industry, there are two main classes of industry. Firstly, there is the large secondary manufacturing industry, supplied for the most part by electric utilities, where the cost of electric energy is a relatively small ingredient of production cost, representing approximately 1/2 of 1% of the total cost of their product; and secondly, there are certain large basic industries normally supplied as direct customers of the Commission. Some of the Niagara Basic Power Users fall in this category, where the cost of power can represent as much as 20% of the total cost of the product.

By supplying these as direct customers, the Commission has been able to treat them in the same manner as other wholesale loads. Most of these direct customers operate 24 hours a day, and some are able to economically use lower grades of power, subject to interruption.

As a result of these factors, these customers today receive the lowest rates in the Province, for example the

average charges per kilowatt-hour to other classes of wholesale customers in 1961 were:

| | |
|---|---|
| Municipal Utilities ..... | 6.74 mills |
| Rural Operating Areas ..... | 8.37 " |
| Mines (Northern Ontario) ..... | 6.21 " |
| Paper Companies (Northern Ontario). | 5.64 " |
| All Direct Customers (SOS) ..... | 5.41 " |
| Niagara Basic Power Users ..... | 4.57 " |

The average charges to retail customers in 1961 were:

| | |
|---|---|
| All Residential Customers, Municipal Utilities ..... | 11.31 mills |
| All Power Customers, Municipal Utilities ..... | 8.66 " |
| All Residential Customers, R.O.A.'s ..... | 20.29 " |
| All Power Customers, R.O.A.'s ..... | 15.29 " |

Surely these figures clearly demonstrate that the interests of the Niagara Basic Power Users as "producers" are in good relationship to other consumers. There are times when many people would like to join with the Niagara Basic Power Users in wishing to turn back the hands of time to the pre war era of 3 mill power, with supplies of even lower cost "dump" power. However, since that time, all conditions governing the Commission's supply of power have radically changed along with those of industry in general. An average cost of 4.57 mills, guaranteed until December 1965, should in all fairness, leave little room for complaint.

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